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Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

In re

JAMES DELBERT McCONVILLE, and CLARA MAE McCONVILLE DBA McCONVILLE ENTERPRISES,

Debtors.

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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63 pp

QUESTIONS PRESENTED

1. Under section 549(a) of the Bankruptcy Code[1], a trustee may avoid an unauthorized, post-petition transfer of property of the bankruptcy estate. Under section 101(54) of the Bankruptcy Code, a "transfer" is broadly defined, and includes every mode of disposing or parting with property or an interest in property, including retention of title as a security interest in property. After the debtors filed their bankruptcy, debtors granted an unauthorized security interest to respondents in property of their bankruptcy estate. The first question presented here is: Is the post-petition granting of a security interest in property of the bankruptcy estate a "transfer" under section 549(a)?

2. Even though the Ninth Circuit Court of Appeals refused to apply Bankruptcy Code section 549 to the transaction, it held that the post-petition financing violated Bankruptcy Code section 364. However, the Court awarded respondents a lien against the estate property on the theory that the transaction could be rescinded, although respondents had *never* sought nor argued for rescissionary relief. The second question presented is: (a) should a transferee of a transfer avoidable under the Bankruptcy Code be allowed to retain the benefit of the transfer by rescinding the transaction and (b) where that equitable relief had never been requested by the transferee or argued to any court, should the Court of Appeals have granted the relief in the first instance, instead of remanding the case to the trial court for trial on the factual issues?

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[1] All references to the Bankruptcy Code are to 11 U.S.C.

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PETITION FOR WRIT OF CERTIORARI

Tevis T. Thompson, Jr., trustee in bankruptcy of James Delbert McConville and Clara Mae McConville ("Petitioner"), respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 26, 1997, in order to resolve a conflict between the Ninth Circuit Court of Appeals, on the one hand, and the Second and Fifth Circuit Courts of Appeals, on the other, with respect to the important issue presented herein. The writ is further sought to have this Court exercise its supervisory power to correct a departure by the Ninth Circuit Court of Appeals from the accepted and usual course of judicial proceedings.

OPINIONS BELOW

The citation for the opinion of the United States Court of Appeals for the Ninth Circuit that gives rise to this petition (App. *infra* A) is *In re McConville*, 110 F.3d 47 (9th Cir. 1997). This opinion replaced a prior order and amended opinion of the Ninth Circuit (App. *infra* B), the citation of which is *In re McConville*, 97 F.3d 316 (9th Cir. 1996). The Ninth Circuit's initial order and opinion in this matter (App. *infra* C) may be found at *In re McConville*, 84 F.3d 340 (9th Cir. 1996). The judgment of the district court (App. *infra* D) is unreported, as were the findings and judgment of the bankruptcy court (App. *infra* E and F).

JURISDICTION

On March 26, 1997, the United States Court of Appeals for the Ninth Circuit entered its order and opinion from which Petitioner seeks review. The Ninth Circuit thereafter denied Petitioner's timely petition for rehearing with suggestion for rehearing *en banc* by order filed on May 27, 1997 (App. *infra* G). Pursuant to Supreme Court Rule 13.3 this petition has been filed within 90 days of the denial of the petition for rehearing.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

Bankruptcy Code § 101(54) provides, in part, as follows:

"In this title – . . .

(54) 'transfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."

Bankruptcy Code § 362(a) provides, in part, as follows:

> "(a) Except as provided in subsection (b) of this section, a petition filed under § 301, 302 or 303 of this title . . . operates as a stay, applicable to all entities, of . . . (4) any act to create, perfect or enforce any lien against property of the estate . . . "

Bankruptcy Code § 364(c) provides, in part, as follows:

"(c) If the Trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt – . . . (2) secured by a lien on property of the estate that is not otherwise subject to a lien . . . "

Bankruptcy Code § 549 provides, in part, as follows:

"(a) Except as provided in subsections (b) or (c) of this section, the trustee may avoid a transfer of property of the estate – (1) made after the commencement of the case; and (2)(A) that is authorized only under § 303(f) or § 542(c) of this title; or (B) that is not authorized under this title or by the court . . . (c) the trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected."

STATEMENT OF THE CASE

On July 8, 1993, James and Clara McConville ("Debtors") contracted to purchase from Bay View Federal Bank ("Bay View") an eight-unit apartment building in Oakland, California (the "Property") for $122,000. The sale terms required escrow to close by August 7, 1993. Debtors initially deposited $10,000 with Bay View, which sum would be forfeited if they defaulted.

On July 14, 1993, Debtors filed a joint, voluntary Chapter 11 petition in bankruptcy.

In early August 1993, Debtors paid an additional $5,000 to Bay View in non-refundable funds to extend the close of escrow to August 13, 1993. Debtors initially anticipated that Cal-State Equities, a company owned by Robert Kamp, would finance the purchase of the Property. When Cal-State Equities decided not to fund the purchase, Debtors requested that such funding be provided by Lawton & Associates and David Margen ("Respondents"). Lawton & Associates was a licensed real estate agent, and it had presented the Property to the Debtors. Lawton shared office space with David Margen, and they both invested in distressed real property, as did Debtors. Although Respondents agreed to finance the purchase, they agreed to loan the money for only a thirty day period.

On August 13, 1993 – almost a month after Debtors filed their Chapter 11 case – the escrow on the Property closed. The deed from Bay View to Debtors was recorded in the Office of the Alameda County Recorder on August 13, 1993. Debtors paid, in cash, $25,460 of the $122,000 purchase price. To finance the balance of the purchase

price, Debtors, on August 12, 1993, executed and delivered to Respondents a $107,000 promissory note which was due and payable in thirty days (the "Note"). While the Note had a face amount of $107,000, Respondents only advanced $97,000.00, withholding $10,000 as a loan fee[2]. As security for the Note, Debtors executed and delivered a deed of trust against the Property in favor of Respondents for $107,000, which deed of trust was recorded with the County Recorder of Alameda County on August 13, 1993, following recordation of the deed.

On September 13, 1993, Debtors' Chapter 11 case was converted to a Chapter 7 bankruptcy, and Petitioner was appointed as the Chapter 7 trustee for the Debtors' bankruptcy estate. Respondents thereafter unsuccessfully moved for relief from the automatic stay to foreclose on the deed of trust. After the bankruptcy court denied that motion, Petitioner filed a complaint to avoid the lien created by the deed of trust, pursuant to Bankruptcy Code section 549(a). Respondents, in turn, asserted in their answer that the deed of trust was a "transfer of real property to a good faith purchaser" under Bankruptcy Code section 549(c), and thus was protected from Petitioner's attempt to avoid the deed of trust. Before the trial, Petitioner, over Respondents' objection, sold the

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[2] The $10,000 loan free for the 30-day $97,000 loan amounted to an annual effective rate of 123.6% in addition to the interest rate on the note. Respondents extracted from debtors an unlawful signed waiver of a state-mandated disclosure statement with respect to the loan fee. They only dropped their claim for the portion of the note representing the loan fee after Petitioner, upon discovery of the waiver, demanded payment of the $10,000.

property for $137,000, free and clear of the lien of the deed of trust, pursuant to an order of the bankruptcy court which transferred the lien, if any, to the proceeds of the sale.

The bankruptcy court, after a trial on the merits, held for the Petitioner and avoided Respondents' lien on the sale proceeds. Judgement Avoiding Lien (App. *infra* F). It held, among other things, that (1) the post-petition transfer and recordation of Respondents' deed of trust was an unauthorized transfer of property of the bankruptcy estate, which violated Bankruptcy Code section 549(a); (2) the transfer of the deed of trust violated the Bankruptcy Code's automatic stay under section 362(a)(4); (3) the transfer of the deed of trust violated Bankruptcy Code section 364; and (4) Respondents did not qualify for the defense under section 549(c) available to good faith purchasers of real property. Findings of Fact and Conclusions of Law (App. *infra* E). The district court affirmed the bankruptcy court's order, holding that Respondents were not "purchasers" under Bankruptcy Code section 549(c). (App. *infra* D).

The Ninth Circuit thereafter issued three written opinions. The initial May 21, 1996 opinion and order affirmed the district court's judgment on the ground that Respondents' recordation of the deed of trust violated the automatic stay, rendering the deed of trust void as a matter of law. (App. *infra* C). The second opinion, which was issued on September 26, 1996 in response to Respondents' first petition for rehearing, amended the May 1996 opinion, but still affirmed the district court's judgment on the ground that the recordation of the deed of trust violated the Bankruptcy Code's automatic stay. (App.

infra B). In both instances, the Ninth Circuit held that Petitioner could not avoid the transfer of the deed of trust under section 549(a) on the ground that the transfer of a lien was not a "transfer" of property.

Respondents then filed another petition for rehearing. In response, the Ninth Circuit, after requesting and receiving letter briefs, withdrew its September, 1996 opinion and issued its third and final opinion and order. (App. *infra* A). There, the Ninth Circuit again held that the granting and recording of the deed of trust was not a "transfer" of property under section 549. (*Id.* pp. 6a-7a). Rather, the Ninth Circuit held that the unauthorized deed of trust violated section 364(c) of the Bankruptcy Code, which permits a debtor to obtain secured credit **only** after a noticed hearing and approval of the bankruptcy court. (*Id.* p. 7a) However the Ninth Circuit, *sua sponte*, then fashioned an equitable remedy holding that the transaction could be rescinded and, pursuant thereto, ordered that Respondents receive a $97,000 lien on the proceeds from the sale of the Property. (*Id.* pp. 8a-9a) At no time had Respondents ever asserted a right to rescission, either offensively or defensively. Petitioner's Petition for Rehearing and Suggestion for Hearing *En Banc* was denied by order dated May 27, 1997. (App. *infra* G). Pursuant to an order entered on June 11, 1997, the Ninth Circuit granted Petitioner's motion to stay the mandate pending the filing of Petitioner's petition for certiorari to this Court.

The jurisdiction of the bankruptcy court was based on 28 U.S.C. §§ 1334 and 157. Jurisdiction of the district court was based on 28 U.S.C. § 158(a). Jurisdiction of the Court of Appeals was based on 28 U.S.C. § 1291.

REASONS FOR GRANTING THE WRIT

I. THE NINTH CIRCUIT'S OPINION DIRECTLY CONFLICTS WITH THE DECISION OF THE SECOND CIRCUIT IN *IN RE PHOTO PROMOTION ASSOCIATES, INC.* AND THE FIFTH CIRCUIT IN *IN RE POINTER* AND CONTRADICTS THE EXPRESS LANGUAGE OF SECTION 101(54) OF THE BANKRUPTCY CODE

The Ninth Circuit's decision conflicts with the Second Circuit's decision in *In re Photo Promotion Associates, Inc.*, 881 F.2d 6 (2nd Cir. 1989) and with the Fifth Circuit's decision in *In re Pointer*, 952 F.2d 82 (5th Cir. 1992). In addition, the decision wholly undermines the definition of a "transfer" found in Bankruptcy Code section 101(54), which definition applies not only to section 549 but to most, if not all of the avoiding power sections of the Bankruptcy Code.

In *Photo Promotions*, the debtor granted a post-petition security interest of its receivables, and the assignee collected monies pursuant to it. Following conversion to Chapter 7, the trustee sued to recover the amounts collected. The Second Circuit affirmed the decisions of the bankruptcy court and district court, holding that the trustee had the right, under Bankruptcy Code section 549(a), to recover the payments made under the financing arrangement entered into in violation of Bankruptcy Code section 364(c). The Court further held that although the assignee had a potential section 503(b) administrative claim, that it first had to return the avoided transfer, and that its administrative claim would be junior to Chapter 7 creditors with superior claims.

In *In re Pointer*, the Fifth Circuit held that the imposition of an unauthorized, post-petition lien against real property was a "transfer" under section 549 of the Bankruptcy Code. The Fifth Circuit looked directly to the definition of the term "transfer" under the Bankruptcy Code, and noted that a "transfer" included every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest. . . . " 952 F.2d at 87. The Court held, however, that a creditor of the bankruptcy estate lacked standing to avoid the lien.

The First Circuit also disagrees in principle with the Ninth Circuit's decision. In both *In re Melon Produce, Inc.*, 976 F.2d 71 (1st Cir. 1992) and *Grella v. Salem Five Cent Savings Bank*, 427 F.3d 26 (1st Cir. 1994) the First Circuit held, in the context of defining a trustee's ability to avoid preferential transfers under Bankruptcy Code section 547, that the creation or perfection of a security interest in property of the bankruptcy estate (during the preference period) was a "transfer" of property as defined by the Bankruptcy Code. See *Melon*, 976 F.2d at 74 and *Grella* 42 F.3d 26 at 29, fn. 5.

The First, Second and Fifth Circuit's holdings are consistent with the Bankruptcy Code's definition of "transfer." The Official Comments to section 101(54) note that this definition was intended "to define transfer as broadly as possible to include any disposition of property or an interest in property." The Ninth Circuit's decision, holding that the granting of a post-filing lien is not a "transfer,"conflicts with this definition of transfer. The decision also conflicts with *U.S. v. Ron Pair Enterprises*,

489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) which held that the plain meaning of language of a statute should control its interpretation. 489 U.S. at 241, 242. Equally as important, by excluding from section 549, a post filing "transfer" of a security interest, when such a transaction constitutes a "transfer" for purposes of preferences (section 547) and fraudulent conveyances (section 548), the Ninth Circuit has violated this Court's "normal rule of statutory construction that" "identical words used in different parts of the same act are intended to have the same meaning." *Sullivan v. Stroop*, 496 U.S. 478, 484, 110 S.Ct. 2499, 2504, 110 L.Ed.2d 438 (1990) (quoting from *Sorenson v. Secretary of Treasury*, 475 U.S. 851, 860 106 S.Ct. 1600, 1606-1607, 89 L.Ed.2d 855 (1986)).

Therefore, the Ninth Circuit's decision in this matter not only conflicts with the First, Second and Fifth Circuits' definition of the term "transfer," but also calls into question trustee's ability to avoid transfers of liens under Bankruptcy Code sections 544 (strong arm clause), 547 (preferences) and 548 (fraudulent conveyances). The conflict is clear and the importance of this decision paramount.

II. IN ALLOWING A TRANSFEREE OF AN AVOIDABLE TRANSFER TO RETAIN THE BENEFIT OF HIS TRANSFER BY AFFORDING THE EQUITABLE REMEDY OF RESCISSION, NOTWITHSTANDING A CLEAR VIOLATION OF THE BANKRUPTCY CODE, THE NINTH CIRCUIT HAS GRANTED A REMEDY NOT PROVIDED FOR IN THE BANKRUPTCY CODE, OPENING A POTENTIAL FLOOD OF LITIGATION BY FUTURE DEFENDANTS IN BANKRUPTCY CASES

The Ninth Circuit definitively held that the transaction constituted an impermissible post-petition secured

loan under Bankruptcy Code section 364(c)(2). (App. *infra* A, p. 7a). The usual remedy in such an instance is that the transferee of the improperly secured debt loses the lien, and is relegated to the status of an administrative or unsecured creditor. See, *In re Photo Promotion Associates, Inc., supra,* 881 F.2d 6 (2nd Cir. 1989). In contrast, here the Ninth Circuit permitted Respondents to retain the wrongfully-obtained lien, thus receiving priority over administrative or unsecured creditors.

The Bankruptcy Code carefully and specifically sets forth defenses available to transferees of avoidable transfers. As such the Code provides definiteness and predictability to both parties and courts, delineating those transfers which are avoidable, and those which are not. Transferees of avoidable transfers often are unaware of the financial problems of their transferors. For example, many recipients of avoidable preferences under Bankruptcy Code § 547 fall into that category. Yet, unless they can provide a defense under one of the subsections of § 547(c), the code mandates that the transfer be avoided.

The Ninth Circuit decision in this matter changes all of that. By providing for a lien to the transferee under the doctrine of rescission, the Court opened up a completely new and uncharted defense to avoidance actions, not covered by the Code. The transferee who has no statutory defense, now has the right to raise equitable defenses and to seek to rescind the transaction[3]. For example, a supplier who was paid on account of merchandise sold, can

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[3] Since this remedy was first raised *sua sponte* in the final opinion of the Ninth Circuit, Petitioner addressed this argument (and the argument in the next section) to the Ninth Circuit in his unsuccessful petition for rehearing.

meet a preference complaint with a counter claim for rescission,[4] asserting that he will repay the money when the trustee returns the merchandise. The decision of the Ninth Circuit, therefore, potentially opens the floodgate to litigation, and makes undefined, uncertain and unpredictable that which the Code renders definite, certain and predictable.

III. THE NINTH CIRCUIT EXCEEDED ITS AUTHORITY IN GRANTING RESCISSION WHEN IT HAD NOT BEEN SOUGHT, INSTEAD OF REMANDING THE MATTER TO THE TRIAL COURT FOR DETERMINATION

Respondents never sought rescission, either by affirmative defense or counterclaim. They unsuccessfully sought relief from the automatic stay to foreclose on their lien. They unsuccessfully opposed Petitioner's motion to sell the property free of the lien, with the lien, if any, attaching to the proceeds. In asserting those positions, Respondents sought to receive, to the exclusion of the estate, not just the $97,000 loaned to the debtors, but the

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[4] In granting rescission, the Ninth Circuit purported to set forth the equities of the situation. In doing so, the Court incorrectly wrote that the trustee had "stipulated that the Lenders were in good faith." (App. *infra* 8a). The trustee did stipulate that the Lenders had no knowledge of the bankruptcy for purposes of Bankruptcy Code § 549(c). However, he did **not** stipulate that the lenders were "good faith purchasers" as that term is used in Bankruptcy Code § 549(c); in fact the good faith purchaser issue was the only issue tried by the Bankruptcy Court. The trial issue was over the right to assert the *statutory defense* of Bankruptcy Code section 549(c). There was no issue raised, at trial, of the right to assert the *equitable defense* of rescission.

$40,000 excess value above such loan. Respondents never requested rescission from the bankruptcy court, the district court, nor in two regular briefs, two petitions for rehearing and one letter brief, from the Ninth Circuit. (And, naturally, Petitioner never discussed that theory.) The factual basis for rescission was never tried to the bankruptcy court, and Petitioner never had an opportunity to introduce evidence to show why the equitable remedy of rescission should not have been granted.

The idea for rescission was created solely by the Ninth Circuit, as a way to reach a result that was not called for under the law in any of its three opinions.

It has long been the general rule that Courts of Appeal should not consider an issue not passed upon by lower courts. *Singleton v. Wulff*, 428 U.S. 106, 119-120, 96 S.Ct. 2868, 2877, 49 L.Ed. 2d 826 (1976); *Hormel v. Helvering*, 312 U.S. 552, 556, 61 S.Ct. 719, 721, 85 L.Ed. 1037 (1941). As stated in *Hormel*:

> "Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decisions there of issues upon which they have had no opportunity to introduce evidence." 312 U.S. at 556.

The invoking of the remedy of rescission in the third and final opinion of the Ninth Circuit constituted an extreme departure from the accepted and usual course of judicial proceedings as articulated by this Court in *Singleton* and *Hormel*.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Dated: August 11, 1997

Respectfully submitted

KORNFIELD, PAUL & BUPP, P.C.

IRVING J. KORNFIELD
Counsel of Record
Attorney for Petitioner

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	No. 95-15122
	D.C. No. CV-94-03308-FMS
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	ORDER AND OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996
Opinion Withdrawn March 26, 1997
Filed March 26, 1997

Before: James R. Browning and John T. Noonan,
Circuit Judges, and Robert R. Merhige, Jr.,* District Judge.

Opinion by Judge Noonan

*Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Mortgages

After withdrawing its former opinion, the court of appeals modified a judgment of the district court and remanded the case. The court held that the remedy for bankrupt debtors incurring secured debt without court authorization is cancellation of the transaction.

James and Clara McConville (Debtors) filed for Chapter 11 bankruptcy. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, Lenders) agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on the property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders violated § 364; that although the Lenders were purchasers in good faith, recordation of the deed violated the automatic stay provisions; and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by § 549(c). The bankruptcy court

entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, finding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] Both the Trustee and the Lenders argued that the lien in favor of the Lenders was a transfer within the meaning of the bankruptcy code. Both the contentions are blocked by Ninth Circuit precedents holding that the creation of a lien does not transfer property for purposes of § 549(c).

[2] Section 364(c)(2) provides that if the trustee is unable to obtain unsecured credit, the court may authorize the incurring of debt secured by a lien on property of the estate that is not otherwise subject to a lien.

[3] Prior to the appointment of a trustee, the Debtors were fiduciaries of their own estate owing a duty of care and loyalty to the estate's creditors. By incurring secured debt without prior court authorization, the Debtors violated § 364(c)(2). An appropriate remedy for this disregard is cancellation by the court of the transaction. [4] It was equitable that the Lenders get back the amount they lent less what they had already been paid. They were entitled to a lien on the proceeds of the sale of the property.

COUNSEL

Jay-Allan Eisen, Eisen & Johnston Law Corporation. Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp. Oakland, California, for the plaintiff-appellee.

ORDER

The opinion filed on May 21, 1996, and amended on September 26,1996 is hereby WITHDRAWN.

OPINION

NOONAN, Circuit Judge.

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of James D. and Clara M. McConville (the Debtors). The judgment held voidable a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 364 of the Bankruptcy Code, we modify the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The

Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to make the loan on the property. When Kamp did not come up with the cash, the Lenders agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The interest was 12 per cent. The Lenders retained $10,000 of the loan as an additional fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the

Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After a hearing, the bankruptcy court held the Debtors had acted in violation of § 364; that, although the Lenders were purchasers in good faith, recordation of the deed of trust violated the automatic stay of Bankruptcy Code § 362(a)(4); and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] This case was decided by the district court on the basis of § 549, and on the initial appeal both parties argued to this court in terms of § 549. Both parties vigorously argued that the lien in favor of the Lenders was a transfer within the meaning of the bankruptcy code. The Trustee argued that he might avoid it under § 549(a), while the Lenders argued that it qualified for the exception under § 549(c). Whatever the abstract merit of these

contentions, we find them both blocked by our precedents, *In re Schwartz*, 954 F.2d 569, 574 (9th Cir.1992), and *In re Shamblin*, 890 F.2d 123, 127 (9th Cir.1989), which simply hold that the creation of a lien does not transfer property for purposes of § 549.

[2] We asked for further briefing. The parties in effect concede that only an en banc court could change the rulings made in *Schwartz* and *Shamblin*. We are not disposed to ask for an en banc court if there is a simple way of resolving this case. We now hold that the Debtors' obtaining secured credit from the Lenders violated § 364(c)(2).

Section 364(c) and (c)(2) provide:

> (c) If the trustee is unable to obtain unsecured credit allowable under 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining and credit or the incurring of debt –
>
> . . .
>
> (2) secured by a lien on property of the estate that is not otherwise subject to a lien. . . .

§§ 364(c) and (c)(2).

[3] Section 364 is applicable to the Debtors. Prior to the appointment of a trustee, the Debtors were fiduciaries of their own estate owing a duty of care and loyalty to the estate's creditors. *In re March*, 995 F.2d 32, 34 (4th Cir.1993). In such cases, § 364 applies to them. *See In re Century Brass Products*, 22 F.3d 37, 39-40 (2d Cir.1994); 2 *Collier on Bankruptcy*, ¶ 364.02, at 364-6 (1996). By incurring secured debt without prior court authorization, the Debtors violated § 364(c)(2). *See Collier's On Bankruptcy*,

¶ 364.04, at 364-11. An appropriate remedy for this disregard is cancellation by the court of the transaction. It is disruptive of bankruptcy for an estate to obtain fresh credit without regard to the court now supervising the estate. It is within the power of that court to rescind the contract unlawfully made.

The exercise of this corrective power, however, should not occur without regard to the equities of the situation, for, within the limits set by the Code, a bankruptcy court must do equity. *Bank of Marin v. England*, 385 U.S. 99, 103 (1966). The equities here are these: On the one hand, as the Lenders have not ceased to remind us, their loan enabled the Debtors to carry out their contract and so obtain the property for the estate. Moreover, the Trustee stipulated that the Lenders were in good faith, so that the question of their knowledge of the Debtors' actual bankruptcy was removed from the case. On the other hand, the Lenders had to know that the Debtors' position was precarious. The Debtors' inability to obtain the loan they'd counted on, the absence of any effort to get bank financing, and the total amount paid for the loan signalled their situation. In addition, the Lenders' failure to ask for any representation of the Debtors' financial condition amounted to pretty much wilful blindness. The Lenders' lack of knowledge of the Debtors' bankruptcy was not unavoidable.

[4] In these circumstances, we think it equitable that the Lenders get back the amount they lent less what they have already been paid; they should get no benefit from their loan. They are therefore entitled to a lien on $97,000 of the proceeds of the sale of the property.

We remand to the district court with direction to modify the decree of the bankruptcy court so that the Lenders have a lien on $97,000 of the estate.

REMANDED.

APPENDIX B

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: James Delbert McConville, *Debtor.*	No. 95-15122
Tevis T. Thompson, Jr., Trustee, *Plaintiff-Appellee,* v. David Margen; Lawton Associates, *Defendants-Appellants.*	D.C. No. CV-94-03308-FMS ORDER AND AMENDED OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996
Amended September 26, 1996

Before: James R. Browning and John T. Noonan, Jr., Circuit Judges, and Robert R. Merhige,* District Judge.

Opinion By Judge Noonan

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* Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Automatic Stay/Real Estate

The court of appeals affirmed a district court judgment. The court held that an exception to the automatic stay that applies to transfers of real property to a good faith purchaser has no application when, after filing for bankruptcy, debtors execute a deed of trust on property in favor of lenders.

James and Clara McConville (the Debtors) filed a Chapter 11 bankruptcy petition. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, the Lenders), agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Tevis Thompson, Jr., was appointed as trustee. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith

purchaser as provided in an exception created by § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, holding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] No exception to the automatic stay is provided for the creating, perfecting, or enforcing of a lien obtained by a simple lender to the estate.

[2] Ninth Circuit precedents as to real property refuted the Lenders' argument that the deed of trust executed in their favor fell within the exception of § 549(c). [3] All that execution of a deed of trust accomplishes in California is creation of a lien in favor of the creditor. The Ninth Circuit previously held that the mere creation of a lien does "not actually transfer the property itself for purposes of section 549." Under precedents, § 549(c) had no application, and the automatic stay voided the attempted perfection of the lien.

[4] In addition, there was no real property on which a lien under § 549(c) could operate. No transfer was made, and the Lenders' attempted perfection of a lien was void.

COUNSEL

Jay-Allan Eisen, Eisen & Johnston, Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp, Oakland, California, for the plaintiff-appellee.

ORDER

The opinion filed on May 21, 1996 is amended as follows:

Slip opinion p. 6066:

Revise the last sentence to add "as to real property" after "precedents".

Slip opinion p. 6067:

Strike all of ¶ 3 and renumber subsequent paragraphs.

New ¶ 3, last line, add the word "perfection of the" before "lien".

Slip opinion p. 6068, lines 1 and 2:

Place the word "real" before "property".

Slip opinion p. 6068, line 4:

Place "Lenders' " before "attempted". Substitute "perfection" for "creation".

OPINION

NOONAN, Circuit Judge:

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of

James D. and Clara M. McConville (the Debtors). The judgment held void a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 362(a)(4) of the Bankruptcy Code, we affirm the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to make the loan on the property. When Kamp did not come up with the cash, Lawton Associates in conjunction with David Margen (collectively, the Lenders) agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already

filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The Lenders retained $10,000 of the loan as a fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After hearing, the bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was

not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] The transfer of any interest after the filing of the bankruptcy petition is in literal violation of 11 U.S.C. § 362(a)(4), according to which a petition "operates as a stay, applicable to all entities, of . . . any act to create, perfect, or enforce any lien against property of the estate." Section 362(b)(1) through (18) creates explicit exceptions to the automatic stay. No exception is provided for the creating, perfecting or enforcing of a lien obtained by a simple lender to the estate.

This prohibition needs to be reconciled with the exception created by § 549(c), according to which:

> The Trustee may not avoid under Subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy

> or notice of the petition was so filed before such transfer was so perfected.

[2] The Lenders argue that a transfer of property occurred because a transfer is "every mode, direct or indirect, absolute or conditional . . . of disposing of or parting with property or with an interest in property, including retention of title as a security interest." 11 U.S.C. § 101(54); that they are purchasers, because a purchaser "means transferee of a voluntary transfer," *id.* § 101(43); and that the bankruptcy court found as a matter of law that they took the transfer in good faith, so they must be good faith purchasers. Consequently, they contend, the deed of trust executed in their favor falls within the exception of section 549(c) and trumps the prohibition of section 362(a)(4). Their argument is not without force but is refuted by our precedents as to real property.

[3] It is long-established California law that deeds of trust are "practically and substantially only mortgages with a power of sale." *Bank of Italy v. Bentley*, 217 Cal. 644, 657, 20 P.2d 940, *cert. denied*, 54 S.Ct. 74 (1933). All that execution of a deed of trust accomplishes in California is the creation of a lien in favor of the creditor. *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1534 (9th Cir. 1994), *modified* 46 F.3d 969 (1995), *citing Monterey S.P. Partnership v. W.L. Bangham, Inc.*, 49 Cal.3d 454, 460, 211 Cal.Rptr. 587, 777 P.2d 623 (1989). The mere creation of a lien, we held in *In re Schwartz*, 954 F.2d at 574, does "not actually transfer the property itself for purposes of section 549." *Accord, In re Shamblin*, 890 F.2d 123, 127 (9th Cir. 1989). Under these precedents, section 549(c) has no application

and the automatic stay voids the attempted perfection of the lien.

[4] The Lenders have a fall-back position, arguing that under the second sentence of section 549(c) they have at least "a lien on the property transferred to the extent of any present value given." Their fall-back argument has an equitable appeal but it encounters the same difficulty as their principal contention: the statute refers to "the property transferred," but under *In re Schwartz* and *In re Shamblin* no real property was transferred. There is, therefore, no real property on which the lien of the second sentence of section 549(c) may operate. No transfer was made. The Lenders' attempted perfection of a lien was void.

AFFIRMED.

APPENDIX C

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	No. 95-15122 D.C. No. CV-94-03308-FMS OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996

Before: James R. Browning and John T. Noonan, Jr., Circuit Judges, and Robert R. Merhige,* District Judge.

Opinion By Judge Noonan

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* Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Automatic Stay/Real Estate

The court of appeals affirmed a district court judgment. The court held that an exception to the automatic stay that applies to transfers of real property to a good faith purchaser has no application when, after filing for bankruptcy, debtors execute a deed of trust on property in favor of lenders.

James and Clara McConville (the Debtors) filed a Chapter 11 bankruptcy petition. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, the Lenders), agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Tevis Thompson, Jr., was appointed as trustee. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith

purchaser as provided in an exception created by § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, holding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] No exception to the automatic stay is provided for the creating, perfecting, or enforcing of a lien obtained by a simple lender to the estate.

[2] Ninth Circuit precedents refuted the Lenders' argument that the deed of trust executed in their favor fell within the exception of § 549(c). [3] Under a prior Ninth Circuit case, the Lenders' execution of the deed of trust was not "a transfer of the property." [4] All that execution of a deed of trust accomplishes in California is creation of a lien in favor of the creditor. The Ninth Circuit previously held that the mere creation of a lien does "not actually transfer the property itself for purposes of section 549." Under precedents, § 549(c) had no application, and the automatic stay voided the attempted lien.

[5] In addition, there was no property on which a lien under § 549(c) could operate. No transfer was made, and the attempted creation of a lien was void.

COUNSEL

Jay Allan Eisen, Eisen & Johnston, Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp, Oakland, California, for the plaintiff-appellee.

OPINION

NOONAN, Circuit Judge:

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of James D. and Clara M. McConville (the Debtors). The judgment held void a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 362(a)(4) of the Bankruptcy Code, we affirm the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to

make the loan on the property. When Kamp did not come up with the cash, Lawton Associates in conjunction with David Margen (collectively, the Lenders) agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The Lenders retained $10,000 of the loan as a fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After hearing, the bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and

its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] The transfer of any interest after the filing of the bankruptcy petition is in literal violation of 11 U.S.C. § 362(a)(4), according to which a petition "operates as a stay, applicable to all entities, of . . . any act to create, perfect, or enforce any lien against property of the estate." Section 362(b)(1) through (18) creates explicit exceptions to the automatic stay. No exception is provided for the creating, perfecting or enforcing of a lien obtained by a simple lender to the estate.

This prohibition needs to be reconciled with the exception created by § 549(c), according to which:

> The Trustee may not avoid under Subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real

> property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

[2] The Lenders argue that a transfer of property occurred because a transfer is "every mode, direct or indirect, absolute or conditional . . . of disposing of or parting with property or with an interest in property, including retention of title as a security interest." 11 U.S.C. § 101(54); that they are purchasers, because a purchaser "means transferee of a voluntary transfer," *id.* § 101(43); and that the bankruptcy court found as a matter of law that they took the transfer in good faith, so they must be good faith purchasers. Consequently, they contend, the deed of trust executed in their favor falls within the exception of section 549(c) and trumps the prohibition of section 362(a)(4). Their argument is not without force but is refuted by our precedents.

[3] In *In re Schwartz*, 954 F.2d 569, 573 (9th Cir. 1992) we recognized a conflict that "appears troublesome" between § 549(c) and § 362. It was unnecessary for us to resolve the conflict in *In re Schwartz*, which decided only that a tax assessment in violation of § 362 was void. *Id.* 572. Nonetheless in dicta we ventured to say that the

conflict was only apparent because "Section 362's automatic stay does not apply to sales or transfers of property initiated by the debtor." *Id.* at 574. We cited no authority for this explanation. If it were true, it might decide our case in favor of the Lenders whose deed of trust could be argued to be a transfer of property initiated by the Debtors. We find it, however, not necessary to pass upon the truth of the explanation because under *In re Schwartz* itself, the Lenders' execution of the deed of trust was not "a transfer of the property."

[4] It is long-established California law that deeds of trust are "practically and substantially only mortgages with a power of sale." *Bank of Italy v. Bentley,* 217 Cal. 644, 657, 20 P.2d 940, *cert. denied* 54 S.Ct. 74 (1933). All that execution of a deed of trust accomplishes in California is the creation of a lien in favor of the creditor. *St. Angelo v. Victoria Farms, Inc.,* 38 F.3d 1525, 1534 (9th Cir. 1994), *modified* 46 F.3d 969 (1995), *citing Monterey S.P. Partnership v. W.L. Bangham, Inc.,* 49 Cal.3d 454, 460, 211 Cal.Rptr. 587, 777 P.2d 623 (1989). The mere creation of a lien, we held in *In re Schwartz,* 954 F.2d at 574, does "not actually transfer the property itself for purposes of section 549." Accord, *In re Shamblin,* 890 F.2d 123, 127 (9th Cir. 1989). Under these precedents, section 549(c) has no application and the automatic stay voids the attempted lien.

[5] The Lenders have a fall-back position, arguing that under the second sentence of section 549(c) they have at least "a lien on the property transferred to the extent of any present value given." Their fall-back argument has an equitable appeal but it encounters the same difficulty as their principal contention: the statute refers to "the property transferred," but under *In re Schwartz*

and *In re Shamblin* no property was transferred. There is, therefore, no property on which the lien of the second sentence of section 549(c) may operate. No transfer was made. The attempted creation of a lien was void.

AFFIRMED.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES, Debtor.	No. C 94-3308-FMS ORDER AFFIRMING THE BANKRUPTCY COURT'S JUDGMENT
TEVIS THOMPSON, JR., Plaintiff(s), vs. DAVID MARGEN AND LAWTON ASSOCIATES, Defendant(s).	(Filed Dec. 13, 1994)

ISSUES

This appeal requires the Court to decide whether a lender, who records a lien on real property as security for its loan, is a "purchaser" for value of "real property"[1] within the meaning of bankruptcy code § 549(c). For the reasons stated below, the Court AFFIRMS the bankruptcy court's judgment.

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[1] Because the Court affirms the bankruptcy court's judgment on other grounds, the Court declines to address this issue.

BACKGROUND

On July 8, 1993, debtor James Delbert McConville ("McConville") contracted with Bay View Federal Bank to purchase an apartment building in Oakland, California.

On July 14, 1993, McConville and his wife, Clara Mae McConville (collectively, "debtors") filed a chapter 11 petition in bankruptcy.

In order to finance the purchase of the apartment, appellants David Margen ("Margen") and Lawton Associates ("Lawton") (collectively, "appellants"), agreed to loan McConville money after McConville was denied a loan by another lender. A promissory note payable to appellants was executed on August 12, 1993. As security for the note, debtors executed and delivered a deed of trust against the apartment in favor of appellants on August 12, 1993. The deed of trust was recorded on August 13, 1993 immediately following recordation of the deed to debtors.

On September 13, 1993, debtors' bankruptcy case was converted to a Chapter 7 bankruptcy. Appellants sought relief from the automatic stay to foreclose on the apartment, but relief was denied. Bankruptcy estate trustee Tevis Thompson, Jr. ("Thompson") filed a complaint to avoid the lien created by appellants' deed of trust, asserting that such deed was an unauthorized, post-petition transfer under Bankruptcy Code § 549(a). Appellants asserted that the transfer to them was a transfer of real property to a good faith purchaser for value, thereby excluding it from Thompson's avoidance powers.

The Bankruptcy Court held that 1) the recordation of the appellants' deed of trust, post-petition, and without authorization under the Bankruptcy Code or from the court, was avoidable by Thompson pursuant to Bankruptcy Code § 549(a); and 2) that the appellants did not qualify for the defense provided in bankruptcy code § 549(c) as good faith purchasers for value of real property. The Bankruptcy Court therefore entered judgment in favor of Thompson to avoid the appellants' lien.

DISCUSSION

I. Standard of Review

On appeal, the factual findings of a bankruptcy court are reviewed under a clearly erroneous standard, and its legal conclusions are reviewed *de novo*. *In re Pizza of Haw., Inc.*, 761 F.2d 1374, 1377 (9th Cir. 1985).

II. Thompson May Avoid Appellants' Lien Because Appellants Are Not Good Faith "Purchasers" Within The Meaning Of Section 549(c)

Bankruptcy Code § 549(a) provides in pertinent part that a trustee may avoid a transfer of property of the estate made after the commencement of the case, except as provided in § 549(b)[2] or § 549(c). 11 U.S.C. § 549(a). Section 549(c) provides in pertinent part that the trustee may not avoid under § 549(a) a transfer of *real property* to

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[2] The Court need not address the applicability of section 549(b) because lenders have not asserted this defense.

a *good faith purchaser* without knowledge of the commencement of the case for present fair equivalent value. 11 U.S.C. § 549(c) (emphasis added). Appellants assert that as lenders who loaned debtors money after debtors' bankruptcy petition, appellants are good faith purchasers and that the transfer of the deed was a transfer of a real property interest.

A "purchaser" is defined in Bankruptcy Code § 101(43) as including a transferee of a voluntary transfer. Appellants assert that although they are technically lenders, § 21g of the 1939 Bankruptcy Act (the predecessor of § 549(c)) protected lienors in addition to purchasers. Appellants thus reason that they should be protected as "purchasers" under §§ 101(43) and 549(c). Appellants also refer to a secondary source which includes creditors in the "purchaser" definition.[3] Finally, appellants assert that it would be unfair to uphold a decision which effectively leaves appellants with a $97,000 loss.

Thompson responds that appellants are not included within the definition of "purchasers" because "purchasers" has been defined narrowly and lenders do not fit within that definition. Thompson also relies upon judgment-sale cases in which courts have historically treated foreclosing mortgagees less favorably than purchasers. The courts have reasoned in the majority of those cases

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[3] 3 *See* Norton, Bankruptcy Law and Practice 2d 59-7 (1994). Norton fails to cite any binding or persuasive authority for his conclusion and the Court declines to follow Norton's interpretation for the reasons noted herein.

that the mortgagees either had knowledge of the bankruptcy (thus failing the good faith requirement) or did not pay fair equivalent value for the property. Courts have also indicated that the intent behind § 549(c) was not to protect mortgagees at a foreclosure sale. *In re Penfil*, 40 B.R. 474, 478 (Bankr. E.D. Mich. 1984).

After a reasonable search, the Court has found no authority and the parties have not cited any, which determines whether a lender who records a lien on real property, as security for its loan, is a "purchaser" within the meaning of § 549(c). The Court therefore turns to the purpose of the statute.

The purpose of § 549(c) is to protect the innocent purchaser from unscrupulous behavior on the part of the debtor. *In re Purnell*, 92 B.R. 625, 629 (Bankr. E.D. Pa. 1988). More specifically, § 549(c) is to protect against a fraudulent debtor selling real property to an innocent purchaser who has no knowledge, or reasonable means of knowledge, of the pendency of the bankruptcy proceedings. *Id.* (citations omitted). Historically, the section has been invoked when the real estate has been sold in a county outside of where the bankruptcy proceeding is pending. *See* 2 Collier on Bankruptcy, ¶ 21.30 (14th ed. 1976); *In re Allen*, 816 F.2d 325 (7th Cir. 1987).

The Court is swayed by those cases in which foreclosing mortgagees have been treated less favorably than purchasers. *See, e.g., Purnell*, 92 B.R. at 630. Had the present case proceeded to foreclosure, appellants would have received property valued in excess of $120,000 for $97,000, thereby calling into question whether appellants

purchased the land for present equivalent value. Furthermore, the apartment was within the same county in which the bankruptcy was filed (Alameda county); appellants therefore had a reasonable means of obtaining knowledge of debtors bankruptcy.[4]

The Court also finds support for its decision on public policy grounds. If appellants, even in good faith, were given the same favorable treatment as good faith purchasers, lenders in positions similar to appellants would have an incentive not to investigate the financial standing of its potential borrowers because lenders would effectively "leapfrog" over other bankruptcy estate creditors if the loan was made post-petition. Moreover, the collusive possibilities for such an arrangement are high, despite the good faith requirement. Accordingly, the Court holds that appellants are not good faith purchasers under § 549(c).

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[4] While the Court understands appellants' plight, appellants failed to duly investigate debtors' financial standing. Appellants did not require debtors to complete a loan application or submit a financial statement and, instead, relied on past dealings with McConville and a favorable report of debtors' credit history.

CONCLUSION

For the reasons stated above, the bankruptcy court's judgment granting Thompson authority to avoid appellants' lien is AFFIRMED and the hearing scheduled for December 16, 1994 is VACATED.

SO ORDERED.

DATED: December 13, 1994

/s/ Fern M. Smith
FERN M. SMITH
United States District Judge

APPENDIX E

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UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re **JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES,** **Debtors.**	**Case No. 93-44971 N** **Chapter 7**
TEVIS THOMPSON, JR., Trustee in Bankruptcy, **Plaintiff,** **vs.** **DAVID MARGEN and LAWTON ASSOCIATES, a California partnership,** **Defendants.**	**Adversary Proceeding No. 93-4541 N** **FINDINGS OF FACT AND CONCLUSIONS OF LAW** **Date: April 4, 1994** **Time: 9:30 a.m.** **Room: 220** **(Filed Apr. 22, 1994)**

This case came on for trial on April 4, 1994, the court having heard the evidence and considered the stipulations and argument of the parties, states the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. James D. McConville and Clara M. McConville filed a Chapter 11 petition in bankruptcy on July 14, 1993. Said case was converted to a Chapter 7 on September 13, 1993. Plaintiff is the Chapter 7 trustee.

2. On July 2, 1993, the debtors made an offer to Bayview Federal Bank to purchase real property located at 725 South Elmhurst, Oakland, California (the "Property"). Bayview Federal Bank made a counter-offer to said offer on July 8, 1993. Such counter-offer was accepted by the debtor on July 8, 1993.

3. On July 8, 1993, the debtors entered into a contract with Bayview Federal Bank for the purchase of the Property.

4. The debtors subsequently acquired the Property pursuant to such contract.

5. The debtors paid $15,000 directly to Bayview and deposited into escrow an additional $10,460.18, thus paying a total of $25,460.18 toward the purchase of the Property.

6. Bayview executed a grant deed of the Property to the debtors on August 9, 1993, which was recorded on August 13, 1993 in the official records of the Alameda County Recorder's office as instrument no. 93-290112.

7. On or about August 12, 1993, the debtors executed a promissory note in favor of the defendants in the amount of $107,000 to finance the purchase of the Property. Said note was a 30-day note with interest at the annual rate of twelve percent (12%). Defendants charged the debtors a $10,000 loan fee for the making of the loan, which amount was included in the $107,000.

8. On or about August 12, 1993, the debtors executed a deed of trust on the Property in favor of the defendants to secure the note. Said deed of trust was recorded in the official records of the Alameda County Recorder's office on August 13, 1993, as instrument no. 93-290113 following recordation of the deed.

9. Defendants advanced only $97,000 for the benefit of debtors and have agreed, by stipulation, that such amount, plus interest, is the amount of their claim.

10. Defendant Lawton Associates is a California Real Estate Broker and represented debtors in the acquisition of the Property.

11. Defendant Margen shares offices with defendant Lawton and the defendants jointly invest in distressed real property. Defendants were not in the business of making loans.

12. Debtors were engaged in the business of owning and operating distressed real property.

13. The defendants, in making the loan to the debtors, did not require the debtors to complete a loan application or submit a financial statement. However, defendants did make inquiry of debtors' credit history

and received a favorable report on which they reasonably relied.

14. While the terms of the loan were not favorable to the debtors, the evidence indicates that debtors knew what they were doing, and, in the totality of the circumstances, the loan was an arm's length transaction between the defendants and the debtors.

15. No authority was obtained from the bankruptcy court during the Chapter 11 case for the debtors to obtain secured credit.

16. Neither defendant had actual knowledge of the bankruptcy when the deed of trust was taken.

17. This court previously approved the sale of the Property by the trustee with defendants' lien, if any, attaching to the proceeds thereof.

18. To the extent any such findings of fact are determined to be conclusions of law, it shall be deemed to have been set forth herein as a conclusion of law.

CONCLUSIONS OF LAW

1. The real property located at 725 South Elmhurst, Oakland, California, was property of the debtors' bankruptcy estate on August 13, 1993.

2. The debtors' transferring of a deed of trust on said property to the defendants constituted a transfer of property of the estate after the commencement of the case to the defendants. Said transfer was made without approval of the court or the Bankruptcy Code.

3. The transfer of the deed of trust on the Property was in violation of §364 of the Bankruptcy Code.

4. The recordation of the deed of trust on the Property was in violation of §362(a)(4) of the Bankruptcy Code.

5. The transfer of the deed of trust on the property to defendants was not "a transfer of real property to a good faith purchaser" as provided under §549(c) of the Bankruptcy Code.

6. The transfer is avoidable by the trustee pursuant to Bankruptcy Code §549(a).

7. The defendants did take the transfer in good faith within the meaning of Bankruptcy Code §549(c).

8. The defendants did not make any improvements to the property after such transfer within the meaning of Bankruptcy Code §550(d).

9. Plaintiff is entitled to have judgment entered avoiding the lien of the deed of trust and declaring that defendants have no lien against the proceeds of the sale of the Property.

10. To the extent that any of the court's conclusions of law are determined to be findings of fact, they will be deemed to have been set forth herein as findings of fact.

Dated: ___, 1994

RANDALL J. NEWSOME
U. S. Bankruptcy Court Judge

Approved as to form.

/s/ Lynn Anderson Koller
LYNN ANDERSON KOLLER

APPENDIX F

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UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re **JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES,** **Debtors.**	**Case No. 93-44971 N** **Chapter 7**
TEVIS THOMPSON, JR., Trustee in Bankruptcy, **Plaintiff,** **vs.** **DAVID MARGEN and LAWTON ASSOCIATES, a California partnership,** **Defendants.**	**Adversary Proceeding No. 93-4541 N** **JUDGMENT AVOIDING TRANSFER** **(Filed Apr. 22, 1994)**

The trial in the above-captioned matter came on for hearing before the undersigned on April 4, 1994, Irving J.

Kornfield and Howard Rutten appearing on behalf of plaintiff Tevis Thompson, Jr. and Lynn Anderson Koller appearing on behalf of David Margen and Lawton Associates. The court having considered the evidence and argument of counsel, and having made findings of fact and conclusions of law;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiff Tevis Thompson, Jr., Trustee in Bankruptcy, have judgment against David Margen and Lawton Associates, avoiding the transfer by the debtors to the defendants of that certain deed of trust recorded in the Alameda County Recorder's Office on August 13, 1993 as instrument number 93-290113.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, this court having heretofore approved the sale of the property located at 725 South Elmhurst, Oakland, California free and clear of the lien of the defendants, if any, with such lien attaching to the proceeds thereof, said defendants shall have lien on the proceeds of the sale of the Property, and the Trustee shall hold such proceeds free and clear of any lien in favor of the defendants.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that plaintiff shall be awarded costs of suit.

Dated: ___, 1994 /s/ RANDALL J. NEWSOME
U. S. Bankruptcy Court Judge

Approved as to form.

/s/ Lynn Anderson Koller
LYNN ANDERSON KOLLER

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	No. 95-15122
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	D.C. No. CV-94-03308-FMS **ORDER** (Filed May 27, 1997)

Before: BROWNING and NOONAN, Circuit Judges, and MERHIGE* District Judge

The panel as constituted in the above case has voted to deny the petition for rehearing. Judge Browning voted to reject the suggestion for rehearing en banc and Judge Noonan recommended rejection.

The full court has been advised of the suggestion for en banc rehearing, and no judge of the court has

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* Judge Merhige was unable to participate.

requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for a rehearing en banc is rejected.

FILED
SEP 10 1997
CLERK

No. 97-271

In The

Supreme Court of the United States

October Term, 1996

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION

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34 pp

LIST OF INTERESTED PARTIES
(SUPREME COURT RULES 14(b) AND 29.6)

Respondent David Margen and Petitioner Tevis T. Thompson, Jr. are individuals. Mr. Thompson is a party to this matter in his capacity as trustee of the chapter 7 estate of James Delbert and Clara Mae McConville, individuals.

Respondent Lawton Associates is a California general partnership. Its partners are Susan V. Smartt, Louis J. Lovotti, Ronald J. Kriss, and Susan Peck. Lawton Associates has not issued shares to the public, and it is not a parent, subsidiary, or affiliate of any company that has issued shares to the public.

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I.

STATEMENT OF THE CASE

This matter involves the fact-intensive application of an equitable remedy to the unique circumstances of this case. The decision of the Ninth Circuit Court of Appeals follows a half-century of existing authority, creates no conflict among the circuits, and achieves an equitable result.[1] No basis exists for reviewing this case on certiorari.

Because of the discretionary nature of the remedy at issue in this case, it is important for this Court to have a clear presentation of all the circumstances that compelled the Ninth Circuit to reach its equitable result. Unfortunately, the Petition presents a one-sided view of the case, obscuring or ignoring essential factual findings (including at least one to which Petitioner stipulated) that form the basis of the decision below.

The Debtors, James and Clara McConville, were in the business of buying distressed real properties with the intent of operating and reselling them for a profit. Petitioner's Appendix ("Pet. App.") at 4a, 3e. On July 8, 1993, Debtors entered into a contract to purchase a bank-owned apartment building in Oakland, California (the "Property") for $122,000. *Id.* at 4a, 2e. Debtors subsequently opened a thirty-day escrow and made a $10,000, nonrefundable deposit into escrow. *Id.* at 4a. Debtors later made an additional $5,000 nonrefundable deposit to

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[1] As discussed further herein, the Ninth Circuit's only error was to deny Respondents a lien to secure more than four years of interest earned on their loan.

extend the escrow for approximately one week when they were unable to close the transaction timely. *Id.* at 4a-5a, 2e.

Debtors' primary source of financing fell through just before the scheduled closing date. *Id.* at 4a-5a. In order to go forward with the purchase and not forfeit their $15,000 deposit, Debtors requested thirty-day bridge financing from Respondents, David Margen and Lawton Associates. *Id.* at 5a. The parties expected that after thirty days Debtors would be able to obtain permanent financing and repay Respondents. According to the Bankruptcy Court, "[w]hile the terms of the loan were not favorable to the [D]ebtors, the evidence indicates that [D]ebtors knew what they were doing, and, in the totality of the circumstances, the loan was an arm's length transaction between the [Respondents] and the [D]ebtors." *Id.* at 4e.

Respondents had prior business experience with Debtors and did not require Debtors to present a current financial statement. However, Respondents did inquire into Debtors' credit history and received a favorable report. *Id.* at 5a, 3e-4e. The Bankruptcy Court found that Respondents "reasonably relied" upon the information they received regarding Debtors' creditworthiness. *Id.* at 3e-4e. Further, there was no evidence in the Property's chain of title to show that Debtors lacked the authority to grant a first priority purchase money lien on the Property to secure repayment.

On August 13, 1997, Respondents advanced Debtors $97,000 evidenced by a promissory note (the "Note").[2] The Note was secured by a purchase money, first deed of trust on the Property, which was recorded contemporaneously with the recording of Debtors' deed. *Id.* at 3e. Debtors used the moneys Respondents advanced to purchase the Property.

Unbeknownst to Respondents when they made the loan, Debtors were in bankruptcy. Debtors had filed a petition under chapter 11 of the Bankruptcy Code[3] on July 14, 1993, approximately one month before the transaction closed. Debtors failed to record their bankruptcy petition with the county recorder in accordance with Bankruptcy Code section 549(c). Nor did Debtors notify any of the parties to the transaction, including Respondents, of their status as chapter 11 debtors in possession. *Id.* at 5a, 4e. In fact, Petitioner *stipulated* that "[t]he [Respondents], Lawton Associates and David Margen had no knowledge of the filing of a petition in bankruptcy by James and Clara McConville at the time the defendants made a loan to the debtors for the purchase of the Property."

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[2] The Note provided for 12% interest per annum and also included a $10,000 fee. The fee was not paid by Debtors, but rather was accounted for by increasing the face amount of the Note to $107,000. Respondents withdrew their request for the fee prior to trial and agreed to enforce the Note as if its principal amount were $97,000. The fee is *not* a component of the equitable lien granted by the Ninth Circuit, which is limited to the $97,000 actually advanced by Respondents.

[3] All references herein to the "Bankruptcy Code" are to title 11 of the United States Code, 11 U.S.C. § ___.

Debtors failed to make a single payment to Respondents on account of the Note. As of the present, the entire $97,000 Respondents advanced remains unpaid, in addition to more than four years of accrued, unpaid interest.

On September 13, 1993, Debtors' chapter 11 case was converted to one under chapter 7 of the Bankruptcy Code, and Petitioner was appointed as trustee of Debtors' chapter 7 bankruptcy estate. Respondents unsuccessfully sought permission to foreclose on the Property on account of Debtors' failure to repay the loan. Petitioner ultimately resold the Property for $137,000, resulting in a $15,000 profit. Despite their lien on the Property, Respondents have never been repaid their loan from the sale proceeds.

Petitioner brought this action to avoid Respondents' deed of trust, thereby seeking to retain all of the proceeds of the Property's sale for the Debtors' estate. Petitioner alleged that Respondents' deed of trust was avoidable under Bankruptcy Code section 549(a), which provides for the avoidance of unauthorized postpetition "transfers" of estate property. According to Petitioner, because Debtors failed to obtain court approval for Respondents' secured loan, the loan and deed of trust violated both the automatic stay of Bankruptcy Code section 362 and the restrictions on postbankruptcy financings of section 364. Due to Debtors' insolvency, the probable effect of Petitioner's action, if successful, would be to deprive Respondents of any recovery whatsoever on their loan.

In defense, Respondents introduced evidence that they had acted in good faith and without knowledge of Debtors' bankruptcy case. Respondents sought protection under Bankruptcy Code section 549(c), which exempts

from the trustee's section 549(a) avoiding powers real property transfers to "good faith" transferees without knowledge of the pending bankruptcy.[4] Respondents further requested that, if their deed of trust were avoided, they be granted a "Federal improvement lien" on the Property to the extent they advanced funds to Debtors that benefited the bankruptcy estate.

The Bankruptcy Court ruled in favor of Petitioner and avoided Respondents' lien. The Court found that Respondents had acted in good faith in making the loan, Pet. App. at 5e, that they had no knowledge of the bankruptcy at the time the loan was made, *id.*, and that the loan was a bona fide, arm's length transaction, *id.* at 4e. The Bankruptcy Court nonetheless concluded that the creation and recordation of the deed of trust without prior court approval violated Bankruptcy Code sections 362 and 364, and was avoidable under section 549(a). *Id.* The Bankruptcy Court further held that Respondents were not entitled to the protections of Bankruptcy Code section 549(c) for good faith transferees because, according to the Bankruptcy Court, the transfer to Respondents was not a "transfer of real property." The District Court affirmed on the grounds that the lien was avoidable under Bankruptcy Code section 549(a), without addressing sections 362 or 364.

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[4] Specifically, Bankruptcy Code section 549(c) exempts from the section 549(a) avoiding powers "a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value. . . ." The term "purchaser" under Bankruptcy Code section 101(43) includes any recipient of a voluntary transfer.

The Ninth Circuit initially affirmed the lower courts' decisions, but on different grounds. Applying Ninth Circuit precedents, *In re Schwartz*, 954 F.2d 569, 574 (9th Cir. 1992), and *In re Shamblin*, 890 F.2d 123, 127 (9th Cir. 1989), the Court held that the postbankruptcy creation and recordation of Respondents' lien was not a "transfer" for purposes of Bankruptcy Code section 549. Thus, the Ninth Circuit rejected both Petitioner's argument that Respondents' deed of trust could be avoided under Bankruptcy Code section 549(a), and Respondents' argument that their lien was unavoidable because the good faith defense of section 549(c) applied. Instead, the Ninth Circuit initially held that Respondents' lien was void solely because it violated the automatic stay of Bankruptcy Code section 362.

Upon petition for rehearing, the Ninth Circuit requested further briefing and invited the parties to raise any legal issues relevant to resolution of the appeal. In addition to renewing his section 362 and 549(a) arguments, Petitioner reasserted that Respondents' loan violated Bankruptcy Code section 364. Respondents in turn directed the Court to cases which have allowed good faith lenders to retain their liens notwithstanding any violation of section 364 when a benefit is conferred upon a debtor's estate.

The Ninth Circuit ultimately vacated its prior decision and reversed, concluding that Bankruptcy Code section 364 is the proper statutory basis for resolving this dispute. Unlike Bankruptcy Code sections 362 and 549, which are of more general application, Bankruptcy Code section 364 expressly applies to "obtaining credit" and the voluntary granting of postbankruptcy liens, such as

Respondents' loan to Debtors. The Ninth Circuit held that, by obtaining secured credit without a court order, Debtors violated Bankruptcy Code section 364(c), which generally requires that such credit be obtained only after notice and a hearing. The Ninth Circuit accordingly annulled the unauthorized loan transaction.

Since Debtors already had received and spent the loan proceeds to purchase the Property, Debtors could not simply return the proceeds. Recognizing its authority to take into account "the equities of the situation . . . within the limits set by the [Bankruptcy] Code," Pet. App. at 8a, the Ninth Circuit granted to Respondents an equitable lien for $97,000, the amount they had advanced to Debtors.

In determining whether an equitable lien was appropriate, the Ninth Circuit weighed the equities of the case, including the facts that Respondents' loan enabled Debtors to obtain the Property (which was resold for a profit), the loan benefited the estate, and Respondents had acted without knowledge of the bankruptcy case. The Ninth Circuit concluded that "[i]n these circumstances, we think it equitable that the [Respondents] get back the amount they lent. . . . " *Id.* The Ninth Circuit ordered a remand to the lower courts to provide that Respondents "have a lien on $97,000 of the estate." *Id.* at 9a. The Ninth Circuit did not, however, grant Respondents a lien to account for the more than four years of unpaid interest which had accrued on the loan. Thus, while Respondents are to be repaid the moneys they advanced, the bankruptcy estate effectively still will have received a four-year, interest-free loan.

II.

SUMMARY OF THE REASONS WHY THE PETITION SHOULD BE DENIED

This case clearly does not satisfy the criteria this Court routinely applies when considering whether to grant certiorari. The Ninth Circuit's decision does not establish any new precedent, but rather faithfully applies well established equitable doctrines to the unique facts of this case.

The Ninth Circuit's application of Bankruptcy Code section 364 is entirely consistent with the holdings of other courts which have recognized equitable remedies for unauthorized postpetition borrowings. The undisputed record in this case shows that Respondents acted in good faith, without knowledge of the bankruptcy, and for the benefit of Debtors' estate. The granting of an equitable lien to Respondents is correct as a matter of law, equity, and common sense.

Although Petitioner asserts circuit conflicts and a "flood of litigation" resulting from the decision below, none of Petitioner's arguments ring true. The Ninth Circuit's focus on the peculiar facts of this case significantly limits the decision's precedential value.

The "conflicting" cases Petitioner cites are distinguishable, or suggest some indirect tension at most. By asserting these "conflicts", Petitioner is effectively asking this Court to grant certiorari to interpret a statute that is the subject of a single string citation in the decision below. Moreover, if, as Petitioner contends, this statute governed the outcome of this case, then Respondents would be entitled to various defenses that would provide

an independent basis for the Ninth Circuit to reach the same result.

Finally, Petitioner's claim of procedural error is unavailing. The granting of a lien in Respondents' favor was well within the Ninth Circuit's authority and consistent with the form of the relief sought by the parties in this case. In any event, even if the procedural issues Petitioner raises were valid, they do not implicate conflicts among the circuits or other issues of national significance, and thus do not justify granting the Petition. The Petition should be denied.[5]

III.

REASONS FOR DENYING THE PETITION

A. The Grant Of An Equitable Lien In An Amount Equal To The Funds Respondents Advanced To Debtors Is An Appropriate Discretionary Remedy Under Bankruptcy Code Section 364 And Is Consistent With Well Established Case Law.

1. The Courts Have Broad Discretion To Fashion Equitable Relief To Protect Third Parties Who Lend Money To A Debtor In Good Faith And Without Knowledge Of The Bankruptcy Case.

Bankruptcy Code section 364 provides that a bankruptcy trustee or debtor in possession may obtain priority or secured credit outside of the ordinary course of business "after notice and a hearing." As Petitioner correctly

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[5] In the event the Petition is granted, this Court should also grant Respondents' Conditional Cross-Petition, which is being filed concurrently with this opposition.

notes, the consequence of failing to obtain prior court approval of such credit generally will include a denial of any priority or lien status for the lender. *See William B. Schnach Retirement Trust v. Unified Capital Corp. (In re Bono Dev., Inc.)*, 8 F.3d 720, 722 (10th Cir. 1993). Petitioner fails to acknowledge, however, that this general rule is subject to equitable exceptions that the Ninth Circuit correctly applied in this case.

For more than half a century, courts have recognized their authority to approve the terms of loans to debtors *nunc pro tunc* if the equities of the case so dictate. *See Wolf v. Nazareth Fair Grounds & Farmers' Market, Inc.*, 280 F.2d 891 (2d Cir. 1960) (per curiam); *In re American Cooler Co.*, 125 F.2d 496 (2d Cir. 1942); *see also* 3 *Collier on Bankruptcy* ¶ 364.03[2] at 364-9 (15th ed. rev. 1996). While such relief generally should be granted only in "unusual circumstances," courts may do so when the lender acted in good faith and the debtor's other creditors benefited from the loan. *See Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Associates, Inc.)*, 881 F.2d 6 (2d Cir. 1989); *American Cooler*, 125 F.2d at 497.

Moreover, even when an after-the-fact authorization of an entire loan transaction is not appropriate, courts have the power to grant good faith lenders equitable relief, including lien creditor status, as did the Ninth Circuit in the present case. *See, e.g., In re Smith*, 119 B.R. 558 (S.D. Ohio 1989) (affirming grant of equitable lien to secure unauthorized postpetition financing); *Bensten v. Grant (In re Gloria Mfg. Corp.)*, 65 B.R. 341, 346-48 (E.D. Va. 1985) (affirming bankruptcy court's grant of super priority over all other creditors on account of unauthorized loan that benefited estate); *National City*

Bank v. Imbody (In re Imbody), 104 B.R. 830, 834-36 (Bankr. N.D. Ohio 1989) (granting *nunc pro tunc* approval of postpetition secured financing); *see also In re City Wide Press, Inc.*, 110 B.R. 710, 711 (E.D. Pa. 1990) (recognizing that court has "discretionary power to authorize a senior claim under § 364(d) *nunc pro tunc*," but declining to do so due to lack of any writing evidencing secured loan); *In re Lite Coal Mining Co.*, 122 B.R. 692, 695-96 (Bankr. N.D. W. Va. 1990) (recognizing court's authority to grant super priority status under section 364(c), but declining to do so on facts of case).

The equities of the present case weigh even more heavily in favor of an equitable lien than those in *In re Smith, supra*, in which the district court affirmed the grant of such a lien for the benefit of a postpetition lender who had failed to obtain prior bankruptcy court approval for its loan. The lender ("Ohio Grain") had extended $100,000 in credit to a chapter 11 debtor in possession secured by a lien on the debtor's crops. Ohio Grain was aware of the debtor's bankruptcy, but mistakenly believed that prior approval of the loan was unnecessary. Another creditor asserting a competing lien on the crops challenged Ohio Grain's lien, claiming that the lien was void under Bankruptcy Code section 364.

Notwithstanding Ohio Grain's failure to follow proper procedure, the bankruptcy court granted Ohio Grain an equitable lien on the crops, and the district court affirmed. According to the district court:

> This is not a case where the debtor has attempted to grant a lien to a creditor in previously unencumbered property at the expense of general creditors. The fundamental fact is that

> Ohio Grain's loan did not just preserve the bankruptcy estate, but in fact created a portion of that estate. In the absence of Ohio Grain Company's loan, the estate would not have possessed the 1986 crop. Despite the failure of Debtors and Ohio Grain Company to follow the proper procedures in gaining court approval for the loan, this Court agrees with the Bankruptcy Court that it would be unjust to permit Debtors' other creditors to profit from Ohio Grain Company's mistake.

119 B.R. at 565 (quotations omitted).

In the present case, Respondents' loan likewise did not encumber existing estate property at the expense of other creditors. Respondents' loan created an asset by enabling the Debtors to purchase the Property, which was later resold for a profit. Without this loan, Debtors would not have acquired the Property, and instead would have forfeited their $15,000 nonrefundable deposit. Moreover, the record in this case is clear that Respondents acted in good faith and had no knowledge of Debtors' chapter 11 case, due in large part to Debtors' own failure to notify the parties of their bankrupt status. Finally, it is unlikely that Respondents will ever be repaid so much as a penny of their $97,000 absent a lien on the sale proceeds. Consistent with the holdings of *American Cooler*, *In re Smith*, and other cases which have recognized the courts' discretion to award equitable relief to good faith lenders, the Ninth Circuit reasonably concluded that "[i]n these circumstances, we think it equitable that the [Respondents] get

back the amount they lent," and granted them a lien in that amount. Pet. App. at 8a.[6]

2. The Ninth Circuit's Holding Is Consistent With The Second Circuit's Holding In *Photo Promotion Associates.*

Petitioner mischaracterizes the Second Circuit's decision in *Photo Promotion Associates* in an effort to create the appearance of a conflict where none actually exists. In fact, *Photo Promotion* recognizes the same equitable principles applied by the Ninth Circuit in this case, and its reasoning supports the decision below.

In *Photo Promotion,* a creditor ("Colorchrome") entered into a post-bankruptcy financing agreement with the debtor that was secured by an assignment of the debtor's accounts receivable. Colorchrome failed to obtain court approval for the secured financing even though, unlike Respondents, Colorchrome knew that the debtor was in chapter 11. *See Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Associates, Inc.),* 87 B.R. 835, 837 (Bankr. S.D.N.Y. 1988). The bankruptcy court on motion for summary judgment invalidated Colorchrome's security interest for failure to obtain court approval under Bankruptcy Code section 364(c). On remand from an initial appeal to the district court, the bankruptcy court granted Colorchrome administrative priority status

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[6] Respondents believe that the Ninth Circuit's only mistake was failing to protect their rights fully by extending the equitable lien to include not just the principal amount loaned, but also any interest earned at the contract rate of 12% per annum.

for its claims, but required Colorchrome to refund any payments it had already received.

In affirming the lower courts' decisions, the Second Circuit made it clear that the courts have "broad discretion" in applying Bankruptcy Code sections 364 and 549 and fashioning remedies thereunder. 881 F.2d at 8. "[A] court may authorize administrative expenses retroactively when the equities of the situation require it. . . . " *Id.* at 9 (following *Wolf v. Nazareth Fair Grounds*, 280 F.2d at 892; *American Cooler*, 125 F.2d at 497). "Whether to grant or deny retroactive authorization requires an ad hoc assessment of the facts and equities of each case." *Id.*

As did the Ninth Circuit in the present case, the Second Circuit emphasized that the primary considerations are " 'the good faith of the debtor and lender [and] whether or not they honestly believed that they had authority to enter into the transaction.' " *Id.* (quoting *American Cooler*, 125 F.2d at 497). These are precisely the considerations that the Ninth Circuit took into account in awarding equitable relief to Respondents.

Contrary to Petitioner's assertion, the Second Circuit did not hold (or even suggest) that it lacked authority to grant the lender an equitable lien or other form of security. The Second Circuit did not authorize a lien in *Photo Promotion* only because the equities in that case were significantly different from those present here. Among other things, Colorchrome admitted that it knew that the debtor was under the protection of the bankruptcy laws when it made the loans. Under these circumstances, the Second Circuit held that "[t]he equities of this case . . . weigh heavily against retroactive authorization" of a

secured financing. 881 F.2d at 9. In any event, the question of Colorchrome's security was not even before that court, because Colorchrome abandoned on appeal its right to "contest [the bankruptcy] court's ruling that the debtor's assignment of its accounts receivable to Colorchrome did not create a security interest because of the absence of court approval." 87 B.R. at 837.

The Second Circuit's holding, which recognizes a court's discretion to weigh the equities of the particular case, is entirely consistent with what the Ninth Circuit did below. Although the Second Circuit declined to apply the same remedy as did the Ninth Circuit, that is not because of any conflict in the law. Rather, it is because the courts faced significantly different factual circumstances. There is no conflict as to the basic legal principle that courts have the discretion to formulate equitable remedies under section 364. Certiorari on this issue is not warranted.

B. Nearly All Of Petitioner's Other Asserted Grounds For Granting Certiorari Involve Interpretations Of Statutes That Did Not Form The Basis Of The Ninth Circuit's Decision, And That Would Not Have Entitled Petitioner To The Relief He Seeks.

The majority of the Petition is devoted not to Bankruptcy Code section 364, which formed the basis for the Ninth Circuit's decision. Rather, the Petition's main focus is (i) the avoiding powers in Bankruptcy Code section 549(a), which the Ninth Circuit found to be inapplicable in this case and disposed of in a single string citation, *see* Pet. App. at 7a (citing *In re Schwartz*, 954 F.2d at 574; *In re*

Shamblin, 890 F.2d at 127), and (ii) the definition of the term "transfer" in Bankruptcy Code section 101(54), which the Ninth Circuit did not even cite. Petitioner wants this Court to grant certiorari to shift the focus of this case to Bankruptcy Code sections 101(54) and 549(a), and to address a multitude of collateral issues that are not the subject of the Ninth Circuit's decision.

As the following discussion demonstrates, none of the "conflicts" and concerns Petitioner cites warrant this Court's intervention. At most, Petitioner identifies some tension among various cases decided in different contexts; none of the cases Petitioner cites squarely conflicts with the Ninth Circuit's decision in this case to rely exclusively upon section 364. Moreover, even if Petitioner were correct that sections 101(54) and 549(a) should have been applied in this case, Respondents would be entitled to assert various defenses under those sections (none of which were resolved by the Ninth Circuit) that would provide independent grounds for affirming the Ninth Circuit's decision. Given the lack of any clear conflict and the existence of defenses that the Ninth Circuit had no occasion to address, this case is not a worthy candidate for review on certiorari.

1. To The Extent Any Tension May Exist In The Interpretation Of Bankruptcy Code Sections 101(54) And 549(a), This Tension Does Not Give Rise To Any Issue Justifying This Court's Review.

In both *Schwartz* and *Shamblin*, the Ninth Circuit held that the postpetition creation of a lien does not constitute

an avoidable "transfer" for purposes of Bankruptcy Code section 549(a). *See Schwartz*, 954 F.2d at 574; *Shamblin*, 890 F.2d at 127. Petitioner contends that, by acknowledging these precedents in this case, the Ninth Circuit has perpetuated conflicts both with a decision of the Fifth Circuit that considered section 549(a) specifically, and with decisions of various courts that have interpreted the term "transfer" in the context of other provisions of the Bankruptcy Code.

The principal case upon which Petitioner relies is *City of Farmers Branch v. Pointer (In re Pointer)*, 952 F.2d 82 (5th Cir.), *cert. denied sub nom., Pointer v. Carrollton-Farmers Branch Indep. Sch. Dist.*, 505 U.S. 1222, 112 S. Ct. 3035 (1992), in which a secured creditor sought to avoid an involuntary tax lien that arose after the commencement of the debtor's bankruptcy. The creditor argued that the creation of the tax lien was an unauthorized "transfer" of property of the debtor's estate. The Fifth Circuit held that the creditor lacked standing to avoid the lien under section 549 and directed that the action be dismissed. *Id.* at 87-89. Before reaching the standing issue, however, the court briefly discussed the applicability of section 549 to the avoidance of involuntary, postpetition liens. In what was arguably dicta, given the creditor's lack of standing, and without citing the Ninth Circuit's prior holdings on the issue, the court indicated that the attachment of the involuntary lien did constitute a "transfer" for purposes of section 549. *Id.* at 87.

Pointer is distinguishable because it involved an involuntary tax lien, rather than a voluntary financing. By its terms, Bankruptcy Code section 364 applies only to voluntary agreements to extend postpetition credit. Thus,

the equitable doctrines that protect good faith lenders were not applicable in *Pointer*, and the Fifth Circuit had no occasion to address them. In contrast, the Ninth Circuit based its decision in the present case exclusively on Bankruptcy Code section 364, rather than section 549, because Respondents' loan to Debtors was a voluntary transaction. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384-85, 112 S. Ct. 2031, 2037 (1992) (more narrowly tailored statute has precedence over statute of general application). Because section 364 forms the underpinnings of the Ninth Circuit's decision in this case, the Ninth Circuit correctly applied the equitable doctrines relating to that statute's application that simply were unavailable in *Pointer*.

The other "conflicts" Petitioner cites involve cases which have nothing to do with the prohibition on unauthorized, postpetition loans. They deal instead with matters such as the avoidance of prebankruptcy preferential and fraudulent transfers under Bankruptcy Code sections 547 and 548. According to Petitioner, the Ninth Circuit's decision will have the effect of exempting the creation of liens from numerous provisions of the Bankruptcy Code that historically have been applied to them. Nowhere in its decision, however, did the Ninth Circuit suggest, or even imply, that its holding would affect the law of preferences, fraudulent conveyances, or any other aspect of bankruptcy law, other than unauthorized postpetition financings under Bankruptcy Code section 364. In fact, the Ninth Circuit has expressly precluded reliance upon its holdings in *Schwartz* and *Shamblin* in any context other than the creation and avoidance of postpetition liens. *See Shamblin*, 890 F.2d at 127 n.7 (recognizing that,

in the context of prebankruptcy transactions, "[t]his court has consistently treated the creation of liens on the debtor's property as a transfer"); *see also Hughes v. Lawson (In re Lawson)*, 1997 WL 469694 (9th Cir. Aug. 8, 1997) (case decided *after* the decision below was reported, holding that creation of a lien was a "transfer" for purposes of determining a debtor's eligibility for discharge under section 727(a)(2)); *In re Wind Power Systems, Inc.*, 841 F.2d 288, 291-92 (9th Cir. 1988) (applying Bankruptcy Code section 547 in action to avoid alleged preferential transfer of lien).

Even if there were some tension among the circuits in connection with their interpretations of the term "transfer" in differing contexts, this tension appears not to have created any significant litigation in the courts to date. During the eight years since the Ninth Circuit decided *Shamblin*, not a single published decision has criticized its holding on this issue. Nor has any court appeared to have commented upon, or even identified, the existence of any conflict on this issue. Thus, Petitioner's assertion that the Ninth Circuit's decision "potentially opens the floodgate to litigation" rings hollow.

The Ninth Circuit's decision applies eight-year old precedent in the area of section 549(a), and fifty-year old precedent in the area of section 364. If this precedent were as potentially unsettling as Petitioner asserts, it certainly has not manifested itself as such to date. While it is possible that this Court may someday have to consider the interrelationship between Bankruptcy Code sections 101(54), 364, and 549, this Court should not grant certiorari to correct problems that do not currently exist.

This Court does not address conflicts that exist only in petitioners' imaginations.

2. Even If This Court Were To Conclude That The Creation Of Respondents' Lien Was A Transfer For Purposes Of Bankruptcy Code Section 549, The Ninth Circuit's Decision Should Be Affirmed On Independent Grounds.

Were this Court to agree with Petitioner that this case should be resolved under Bankruptcy Code section 549, as opposed to section 364 as the Ninth Circuit held, then this Court will also have to address at least two defenses to the avoidance of Respondents' deed of trust under section 549(a). Each of these defenses would provide an independent, alternative ground for affirming the Ninth Circuit's decision.

a. Respondents Would Be Entitled To The Protections Of Section 549(c) As Good Faith Transferees Of Real Property.

While Bankruptcy Code section 549(a) authorizes the avoidance of certain postpetition transfers of property of a debtor's estate, its application is circumscribed by affirmative defenses set forth in Bankruptcy Code sections 549(b) and (c). Of relevance here is section 549(c), which protects good faith transferees of real property by providing that:

> the trustee may not avoid under [section 549(a)] a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent

> value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser.

The record in this case is clear that Respondents acted in "good faith", that they had no knowledge of Debtors' bankruptcy case, and that Debtors failed to record their bankruptcy petition. The only question is whether Respondents were "purchaser[s]" of real property as that term is used in section 549(c). Under Bankruptcy Code section 101(43), any recipient of a voluntary "transfer" qualifies as a "purchaser". *ATC Systems, Inc. v. Valairco, Inc. (In re Valairco, Inc.)*, 9 B.R. 289, 295 (Bankr. D.N.J. 1981) ("A perfected secured creditor's lien is, thus, a purchase within the contemplation of the drafters of the Bankruptcy Code. . . . "). Thus, if the creation and recordation of Respondents' lien qualified as a "transfer" for purposes of section 549(a), as Petitioner contends, then Respondents who were the voluntary recipients of that transfer would qualify as "good faith purchaser[s]" for purposes of section 549(c). *See Brown v. Harris (In re Auxano)*, 96 B.R. 957, 960 (Bankr. W.D. Mo. 1989) (applying section 549(c) to protect holder of deed of trust). Because Respondents were good faith purchasers without knowledge of the bankruptcy, their lien could not be avoided.

b. Respondents' Deed Of Trust Is Unavoidable Under Section 549(a) Because It Did Not Involve A Transfer Of Property Of Debtors' Bankruptcy Estate.

By its own terms, section 549(a) applies only to a "transfer of property of the estate" created by the debtor's bankruptcy. Accordingly, if the interest transferred is in property that does not belong to the debtor's estate, the transfer cannot be avoided under section 549(a). *See Moratzka v. Visa U.S.A. (In re Calstar, Inc.)*, 159 B.R. 247, 252 (Bankr. D. Minn. 1993); *Geekie v. Watson (In re Watson)*, 65 B.R. 9, 11-12 (Bankr. C.D. Ill. 1986).

In *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825 (1991), this Court held that a lien that arose contemporaneously with the debtor's acquisition of property could not be avoided under a statute that provides for the avoiding of liens that affix to a debtor's exempt property. The debtor in *Farrey* had received title to a home as part of a divorce property settlement. Simultaneous with granting title to the debtor, the divorce court granted a lien on the home to the debtor's former spouse securing payments intended to equalize the property settlement. Thus, as with Debtors in this case, the debtor in *Farrey* obtained title subject to a lien created contemporaneously with the transfer of title.

The debtor in *Farrey* subsequently sought to avoid the lien as impairing his homestead exemption under Bankruptcy Code section 522(f)(1).[7] This Court held that

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[7] Section 522(f)(1) provides that "the debtor may avoid the fixing of a lien on an interest of the debtor in property to the

the debtor could not avoid the lien because the avoiding powers in section 522(f)(1) are limited to those situations in which a lien actually "fixed" on the debtor's property. This Court reasoned that "[t]he statute does not say that the debtor may undo a lien on an interest in property." 500 U.S. at 296, 111 S. Ct. at 1829. Rather, by using the term "fixing", Congress intended to impose a temporal requirement, specifically, that a lien attach to a pre-existing interest of the debtor. 500 U.S. at 298, 111 S. Ct. at 1830 ("[U]nless the debtor had the property interest to which the lien attached at some point *before* the lien attached to that interest, he or she cannot avoid the fixing of the lien.") (emphasis in original).

Bankruptcy Code section 549 imposes a similar temporal requirement by making avoidable only transfers of estate property. As with the avoidance rights set forth in section 522(f)(1), the avoidance powers in section 549 presuppose an interest of the estate which can be transferred. *See Farrey*, 500 U.S. at 296, 111 S. Ct. at 1829.

In this case, the Debtors did not own the Property until escrow closed on August 13, 1993, and the grant deed and deed of trust were recorded and delivered in accordance with the escrow instructions. Under California law, Respondents' purchase money lien is deemed to have arisen simultaneously with the transfer of title to Debtors. *See Van Loben Sels v. Bunnell*, 120 Cal. 680, 683 (1898) ("[T]he execution of the deed and the mortgage [are deemed to be] simultaneous acts.") *Guy v. Carriere*, 5

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extent that such lien impairs an exemption to which the debtor would have been entitled" if the lien had not attached.

Cal. 511, 512 (1855) (the conveyance of a deed and creation of a purchase money mortgage "is in the law considered as one act"); *Walley v. P.M.C. Inv. Co.*, 262 Cal. App. 2d 218, 220 (1968) ("The deed and mortgage back are considered as contemporaneous acts and no lien or charge against the purchaser can be prior to the rights of the vendor under his mortgage."). As in *Farrey*, Debtors did not have an interest in the Property until *after* the transaction closed, at which time the Property already was encumbered by Respondents' lien. Because the attachment and recordation of Respondents' lien on the Property did not affect pre-existing property of the estate, they cannot be avoidable under section 549(a).

C. Petitioner's Assertions Of Procedural Error Are Incorrect, And In Any Event Fail To Raise Any Issues Worthy Of This Court's Review.

Petitioner's final argument for certiorari is that the Ninth Circuit somehow exceeded its authority by rescinding the loan transaction and granting Respondents an equitable lien. According to Petitioner, the Ninth Circuit should have remanded to the Bankruptcy Court rather than weighing the equities of the case itself. Petitioner further argues that the issues of rescission and an equitable lien were not properly raised in the courts below.

No procedural error occurred in this case. The Ninth Circuit was not constrained as Petitioner suggests to merely affirm or reverse the Bankruptcy Court's decision in its entirety. Rather, the Ninth Circuit acted within its authority to impose an appropriate, equitable remedy based upon well established law and the circumstances of

this case as determined by the trier of fact below. *See Borman v. Leiker (In re Borman)*, 886 F.2d 273 (10th Cir. 1989) (imposing remedy of equitable lien on appeal where bankruptcy court had avoided judicial lien); *see also Western Oil & Gas v. United States*, 633 F.2d 803 (9th Cir. 1980) (holding in administrative law context that "a reviewing court has discretion to shape an equitable remedy").

The relief granted by the Ninth Circuit is consistent with the relief Respondents sought below, specifically, a lien to compensate them for the value they contributed to Debtors' estate. In fact, Respondents requested in the Bankruptcy Court that, in the event their deed of trust was avoided, they be given a "Federal improvement lien" to the extent they advanced funds to Debtors. Although Respondents requested such a lien under Bankruptcy Code section 550, rather than the courts' equitable powers under section 364, the effect of the lien is identical, and the evidence Respondents presented for such a lien fully supports the Ninth Circuit's decision: Respondents' loan was made in good faith, without knowledge of Debtors' bankruptcy, and for the benefit of Debtors' other creditors.

The issue of rescission should have been no surprise to Petitioner. It was Petitioner in the first instance who sought to rescind the secured loan by bringing his action to avoid Respondents' deed of trust. The avoidance of a transfer under the Bankruptcy Code is tantamount to the annulling or rescission of that transfer. *See, e.g., NLRB v. Martin Arsham Sewing Co.*, 873 F.2d 884, 887 (6th Cir.), *modified*, 882 F.2d 216 (6th Cir. 1989) (holding that avoiding powers allow trustee to "nullify transfers");

McRoberts v. Transouth Financial (In re Bell), 194 B.R. 192, 197 (Bankr. S.D. Ill. 1996) ("the trustee's avoidance of the creditors' liens results in nullification of the transfer of property represented by those liens", which "means that the transfer is retroactively ineffective"); *Congress Credit Corp. v. AJC Int'l*, 186 B.R. 555, 558 (D.P.R. 1995) ("An avoidance nullifies the transfer."). Moreover, the rescission issue is really a "red herring" in this case. The operative relief granted was not rescission, but the equitable lien equal to Respondents' advances to Debtors' estate.

In any event, Petitioner's procedural arguments do not implicate any circuit conflicts or issues of national significance. Instead, Petitioner is asking this Court to grant certiorari to engage in what is at most mere error correction. Even if Petitioner's claims of procedural error were true, Petitioner has failed to demonstrate why this Court should grant discretionary review in these circumstances. *See Ross v. Moffitt*, 417 U.S. 600, 616-617, 94 S. Ct. 2437, 2447 (1974).

IV.

CONCLUSION

This is a fact-intensive case that does not implicate any conflicts of authority or other issues worthy of this Court's review. The Ninth Circuit's decision is correct as

a matter of law and equity. The Petition for Certiorari should be denied.

Respectfully submitted,

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No. 97-271

Supreme Court, U.S.
FILED
OCT 3 1997
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In The

Supreme Court of the United States

October Term, 1996

In re

JAMES DELBERT McCONVILLE, and CLARA MAE McCONVILLE DBA McCONVILLE ENTERPRISES,

Debtors,

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Petitioner Tevis Thompson, Chapter 7 Trustee, respectfully submits the following reply in support of his Petition for Writ of Certiorari.

I. The Ninth Circuit Granted Equitable Relief Under Section 364 Of The Bankruptcy Code Only After It Wrongly Held That Bankruptcy Code Section 549 Was Inapplicable.

Respondents mistakenly seek to paint the Ninth Circuit's holding as a "fact-intensive application" of section 364 of the Bankruptcy Code which is not worthy of this Court's review. They address the Ninth Court's analysis of section 549 claim only secondarily, in almost dismissive terms. Respondents' argument ignores the fact that the Ninth Circuit addressed section 364 only after it summarily, and improperly, held that the post-petition transfer and recordation of Respondents' deed of trust was not a transfer under section 549 of the Bankruptcy Code. Regardless of whether the Ninth Circuit disposed of section 549 in either "a single string citation" or through an exhaustive analysis, its holding contradicts the clear definition of transfer in Bankruptcy Code section 101(54) and the holdings in *In re Photo Promotion Associates, Inc.*, 881 F.2d 6 (2nd Cir. 1989) and *In re Pointer*, 952 F.2d 82 (5th Cir. 1992).

Moreover, Respondents' attempt to distinguish *In re Pointer* fails. Section 101(54) of the Bankruptcy Code does not distinguish between voluntary liens (such as deeds of

trust) and involuntary tax liens. The post-petition creation and recordation of both such liens thus violate section 549. Respondents also misstate the Second Circuit's holding in *In re Photo Promotion Associates, Inc.* In that case, the Chapter 7 trustee brought a section 549(a) adversary proceeding to avoid an unauthorized post-petition assignment of debtor's receivables. The bankruptcy court found in the trustee's favor and avoided the lien under section 549(a). The bankruptcy court also found that the creditor had provided the bankruptcy estate with post-petition services and held that the creditor was entitled to a Chapter 11 administrative claim.

The Second Circuit affirmed the lower court's holding that the transfer of the security interest in debtor's account receivables violated section 549(a), and held that the creditor's administrative claim was junior to the Chapter 7 creditors with superior claims. The Second Circuit did not award an "equitable lien" to the creditor, nor could it. Section 549(c) was the only means by which the Photo Promotion creditor could have prevented the trustee from avoiding its lien under section 549(a). Having held section 549(c) to be inapplicable – and that the creditor could not preserve its lien – it would have been incongruous for the Second Circuit to provide the creditor with an "equitable lien" such as the one fashioned by the Ninth Circuit herein.

While Respondents devote much of their opposition to the propriety of the Ninth Circuit's balancing test and the equitable remedy that it fashioned under section 364,

no such equitable lien is available under section 549.[1] Rather, section 549(c) provides the only means for Respondents to preserve their lien. As discussed below, Respondents cannot satisfy the requirements of section 549(c).

II. Respondents Are Not Protected By Section 549(c).

Respondents were not **purchasers** of **real property** and thus cannot find sanctuary in section 549(c). Section 549(c) states in pertinent part that "The trustee may not avoid under subsection (a) . . . a transfer of real property to a good faith purchaser. . . . " Section 549(c) is meant "to protect against a fraudulent debtor **selling** real property, or its interest therein, to an innocent **purchaser** who has no knowledge, or reasonable means of knowledge, of the pendency of the bankruptcy case." (Emphasis added). *Collier on Bankruptcy*, 15th Ed. Section 549.03, pg. 549-12. Section 549(c) therefore offers a very narrow exception for unauthorized, post-petition transfers. *In re Schwartz*, 954 F.2d 569, 574 (9th Cir. 1992). To satisfy § 549(c), Respondents must demonstrate that their deed of trust

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[1] Not surprising, all of the cases cited by Respondents in which an "equitable lien" was approved involved a nunc pro tunc application of section 364(c). Respondents have not, and cannot, cite to any cases in which a court approved an equitable lien under section 549. In addition, Respondents never requested that the bankruptcy court approve its deed of trust nunc pro tunc under section 364(c). The "Federal Improvement Lien" to which Respondents refer is authorized by section 550(e), which permits certain section 549(c) defendants to obtain a lien for the cost of any post-petition improvements which they made to the property recovered by the trustee.

constituted a transfer of **real property** for which they were good faith **purchasers**. Respondents cannot satisfy either element. Under California law, a deed of trust is personal, not real property, and Respondents are not "purchasers" under applicable bankruptcy law.

Section 101(43) of the Bankruptcy Code defines the term "purchaser" as a "transferee of a voluntary transfer. . . . " While the Bankruptcy Code does not define the term "transferee," the Courts of Appeal consistently apply a "dominion or control test" to determine whether a person is a transferee. See *Bonded Financial Services v. European Am. Bank*, 888 F.2d 890 (7th Cir. 1988); *In re Bullion Reserve of North America*, 922 F.2d 544, 548-549 (9th Cir. 1991): "Although the Bankruptcy Code does not define 'transferee', and there is no legislative history on the point, *we think the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes.*" [Quoting from Judge Esterbrook's opinion in *Bonded Financial Services v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988)] 922 F.2d at 548 (emphasis in 9th Circuit's quotation).

Respondents are not "purchasers" under § 549(c) because they were not "transferees" of the real property. Respondents, as lienholders, did not own, control or manage the real property. It was debtors who had absolute control over the real property. Respondent only had dominion and control over their note and deed of trust, but not the real property itself.

In addition, Respondents' deed of trust is not real property under California law. Respondents received two instruments from debtors: a promissory note and a deed

of trust. Under California law, both of these items are personal property. California Civil Code § 658 defines "real property" as follows: "Real or immovable property consists of: 1. Land; 2. That which is affixed to land; 3. That which is incidental or appurtenant to land; 4. That which is immovable by law. . . . " California Civil Code § 663, in turn, provides that "Every kind of property that is not real is personal."

A deed of trust therefore is personal, and not real property. Indeed, California Civil Code § 2888 states that "notwithstanding an agreement to the contrary, a lien, or a contract for a lien, transfers no title to the property subject to the lien." None of the case law cited by Respondents interprets California Civil Code sections 658, 663 or 2888, or holds that a transfer of a California deed of trust constitutes a purchase of real property under § 549(c).

III. The Creation And Recordation Of Respondents' Deed Of Trust Constituted A Transfer Of Property Of Debtor's Bankruptcy Estate.

Respondents argue that since the bankruptcy estate's interest in the real property purportedly did not exist before their lien was created, there was, under *Farrey v. Sanderfoot*, no transfer of estate property. Respondents' argument falls short on all levels. First, the *Farrey* Court interpreted section 522(f)(1) of the Bankruptcy Code, which authorizes a debtor to avoid the *fixing* of a lien on the *debtor's* interest in property. This Court analyzed section 522(f)(1)'s specific language and held that a debtor could avoid the fixing of a lien only if he owned the property before the lien attached to it.

> "No one asserts that the two verbs [annul and fix] underlying the provision possess anything other than their standard legal meaning: 'avoid' meaning 'annul' or 'undo' . . . and 'fix' meaning to 'fasten a liability upon'. . . . The statute does not say that the debtor may undo a lien on an interest in property. Rather, the statute expressly states that the debtor may avoid 'the fixing' of a lien on the debtor's interest in property. The gerund 'fixing' refers to a temporal event. That event – the fastening of a liability – presupposes an object onto which the liability can fasten. The statute defines this pre-existing object as an 'interest of the debtor in property.' Therefore, unless the debtor had the property interest to which the lien attached at some point before the lien attached to that interest, he or she cannot avoid the fixing of the lien under the terms of § 522(f)(1)." 111 S.Ct. at 1829.

Since *Farrey* was decided, no court has applied its analysis to any of the other avoidance sections of the Bankruptcy Code (i.e., §§ 544, 545, 547, 548, 549, 552), or to § 362. *Farrey's* limited application is not surprising. Section 549(a) has no such temporal limitation. Rather, section 549(a) simply and plainly authorizes a trustee to avoid a transfer of property of the estate made after the commencement of the bankruptcy case. Indeed, the *Farrey* Court made clear that its holding is simply its interpretation of section 522(f)(1)'s exact language. The *Farrey* Court held that section 522(f)(1)

> " . . . cannot be concerned with liens that fixed on an interest before the debtor acquired that interest. Neither party contends otherwise. Section 522(f)(1) does not state that any fixing of a

> lien may be avoided; instead, it permits avoidance of the 'fixing of a lien on an interest of the debtor.' If the fixing took place before the debtor acquired that interest, the 'fixing' by definition was not on the debtor's interest." 111 S.Ct. at 1830.

Respondents also cannot seriously contend that the transfer of the lien was not a transfer of estate property. Property of the bankruptcy estate is wholly distinct from a debtor's interest in property. The phrase "property of the bankruptcy estate" is defined in Bankruptcy Code section 541(a)(1) to include all legal or equitable interests of the debtor in property as of the commencement of the case. The definition is further expanded in section 541(a)(6) to include "products, product, offspring, rents or profits of or from property of the estate . . . and (7) to include 'any interest in property that the estate acquires after the commencement of the case.' " (Emphasis added). The question of what is property for purposes of § 541(a)(1) is a question of federal law. *Board of Trade v. Johnson*, 264 U.S. 1 at 10, 44 S.Ct. 232 at 234, 66 L.Ed. 533 at 536 (1924) (interpreting § 70(a) of the Bankruptcy Act, the predecessor to § 541).

When the debtors filed their Chapter 11 case, they had entered into a binding and enforceable pre-petition contract for the purchase of the real property. (See Appellants' Excerpts of Record 84, Findings 2, 3 and 4). Section 541(a)(1) includes a debtor's pre-petition contract rights. See *In re Computer Communications, Inc.*, 824 F.2d 725 (9th Cir. 1987), *In re Ryerson*, 739 F.2d 1423 (9th Cir. 1984). As a buyer under an executory contract to purchase real property, the debtors had rights in the property. For example,

they had the right to seek specific performance of the contract (see California Civil Code sections 3384 and 3387) and record a notice of lis pendens. California Code of Civil Procedure sections 405.4, 405.20.

When the debtors acquired title to the real property, the entire property became "property of the estate" pursuant to § 541(a)(6)[2] and § 541(a)(7). There can be little doubt, therefore, that the real property was property of the estate both before the actual acquisition of title and, of course, when title was acquired.

Moreover, even if – as Respondents contend – Respondents' lien and transfer of title arose simultaneously, the lien still constituted a transfer of property of the bankruptcy estate. Under California Civil Code section 2883, a lien attaches only when the person granting the lien obtains an interest in the liened property. Simply put, the transfer of the lien to Respondents was dependent upon debtor's ownership of the real property.

Since the concepts of "property of the estate" and "interest of the debtor in property" are so fundamentally different, the *Farrey* Court's analysis is completely

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[2] The fee title to the property is a product or offspring from the contract right owned at the date of filing. See *Bradt v. Woodlawn Auto Workers F.C.U.*, 757 F.2d 512, 515 (2nd Cir. 1985) (Insurance payment for repairs to automobile which was property of the estate was also property of the estate, because definition of "proceeds" in § 541(a)(6) is broader than that term in Uniform Commercial Code. Conversion of form of property of the estate does not change its character as property of the estate).

inapplicable to section 549's prohibition against the post-petition transfer of "property of the estate."

CONCLUSION

The Ninth Circuit's decision creates a clear conflict within the Circuit Courts of Appeal, and the Petition for Certiorari should be granted.

Dated: October 3, 1997

Respectfully submitted,

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